Financial procedures bulletin

CASH MANAGEMENT IN MUNICIPALITIES

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WHAT IS CASH MANAGEMENT?

Cash management is one component of the overall financial management of a municipality. It is the process used to manage the monies available to a local government entity in order to ensure maximum cash availability and maximum yield on the investment of idle cash resources. More specifically, cash management is concerned with the conversion of receivables to cash receipts, the conversion of accounts payable to cash disbursements, the rate at which cash disbursements clear the bank accounts and what is done with the cash balances in the interim.

THE GOALS OF CASH MANAGEMENT

The primary goals of a cash management system are:

1) to maximize the amount of cash available to meet both the daily cash requirements of the municipality and to increase the amount of money available for investment (or alternatively to reduce temporary borrowing to meet current expenses), and
2) to earn the maximum return on monies invested.

The secondary goals that can be achieved through an effective cash management program are:

1) the development or strengthening of internal control particularly in the areas of cash receipts, and cash disbursements;
2) the establishment of tax due dates that more realistically conform to the cash requirements of the municipality;

3) better collection policies concerning outstanding taxes;
4) the establishment of clear lines of communication and authority between the treasurer and the heads of other departments relating to their cash needs;
5) improved relationships between the municipality, its bankers, and members of the investment community;
6) to ensure that all of the available services and techniques of the municipality's bank are utilized to the benefit of the municipality.

WHY HAVE A CASH MANAGEMENT SYSTEM?

Cash is a scarce resource which can be managed to yield significant benefit by any municipality regardless of size. From time to time a municipality may have cash at its disposal which is not immediately required. If this excess cash is not put to work, drawing interest and generating additional revenue, a waste of public funds occurs, just as real as an unnecessary expenditure.

In the May, 1978 issue of "Governmental Finance", a publication of the Municipal Finance Officers Association, in an article on investment pools, it was estimated that in 1972 local governments in the U.S. had surplus cash balances of some $7.5 billion uninvested.

The reasons given for this sizeable amount of uninvested cash were:

1) lack of time: the treasurers or finance directors were too involved in other administrative detail to spend time on detailed cash planning, and

2) absence of control systems over receipts and expenditures that made the forecasting of cash resources extremely difficult, if not impossible.

Although these figures relate to the United States and are some six years old, it is probably safe to assume that conditions similar to the situation in 1972 still exist. Similar conditions almost certainly exist in Ontario today even though some municipalities have instituted excellent investment programs over the past few years.

In light of the financial pressures facing Ontario municipalities many local government entities could make good use of the source of additional non-tax revenues provided by a planned investment program.

IMPLEMENTING A CASH MANAGEMENT SYSTEM

Many feel that a cash management system begins with the design and preparation of a formal cash budget. But actually it starts with a detailed review of the cash handling techniques presently in place in the municipality.

The first area of investigation concerns the identification of the municipality's bank accounts. Many municipalities operate a myriad of bank accounts without apparent justification.

Once the bank accounts have been identified and their reason for existence detailed, the Treasurer should then eliminate those accounts not required by law or not absolutely necessary to the operations of the municipality!

It is usually possible for a municipality to operate with a very limited number of bank accounts. A general bank account, an impress payroll bank account and a consolidated reserve fund bank account are probably sufficient for the needs of most municipalities.

It should be pointed out however that the use of consolidated bank accounts to keep better track of cash flows, can, and usually does, require a more complex record keeping system in order to reconcile capital and revenue fund balances (that may include temporary borrowings and interest charges) contained within one consolidated bank account. The accounting for separate balances for a number of reserve funds contained in a consolidated bank account is another example.

While going through the above exercise of reviewing and determining the number of bank accounts required by the municipality, the Treasurer should take the opportunity to review the calibre and the extent of the services he is receiving from his bank. In doing this he should be aware of and take into consideration any legal agreements that may be in effect between the bank and the municipality.

In the case of certain municipalities the choice of a bank may be non-existent. However, many municipalities have branches available to them, representing all of the major banking concerns. By meeting with the managers of these different banks the Treasurer can perhaps negotiate an arrangement that is more equitable to the municipality than at present.

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Cash Receipts

The next area of review concerns the procedures in place for the handling of cash received by the municipality.

Undeposited receipts cannot be invested at the end of a day and are subject to loss or theft. Although currency is more susceptible to theft, undeposited cheques still present a risk and also represent a loss of potential interest income.

The Treasurer should establish written procedures to cover the handling of all cash and deposits, and should ensure that treasury staff are knowledgeable in their use.

If not already in use, the Treasurer should investigate and give serious consideration to the use of banks as a direct collector of tax receipts and utility bills for which the municipality has responsibility.

While the above may entail modifying accounting and recording procedures, the benefits of having cash deposited directly to the municipality's account and immediately available for investment will usually offset the costs of revising the accounting system.

Cash Disbursements

The control of cash disbursements should be reviewed by the Treasurer as his next step in implementing the program.

A good cash disbursements system will ensure as far as possible that cheques are issued on a regular basis and

only when they are due. Payrolls are normally scheduled on a weekly, biweekly or monthly basis and do not represent a problem in scheduling payment dates. The standard invoices received from the municipality's suppliers do however require a defined procedure if a tight schedule of payments is to be maintained.

The rule for vendors' invoices then should be "take advantage of all discounts and pay all others as late as the terms of the invoices will allow." To support this, an invoice offering a 2% discount for payment in ten days, as opposed to no discount when the full bill is due in thirty days, is equivalent to an interest rate of 36 per cent per annum.

In order to avoid bottlenecks, invoices should be approved on a regular basis, processed through the accounting system and then held in the pending file until the due date has been reached. Consideration must also be given to payment of regular expenditures not normally supported by a formal invoice such as debt charges and property rentals.

As was the case of cash receipts, a written procedure should be developed for the payment of all municipal expenditures and this procedure must be understood by the Treasurer's staff. The policy laid out should also contain the procedure for handling the occasional payment that must be made immediately.

In addition to the Treasurer's staff, all other department heads of the municipality must be aware of and

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understand the policy on cash disbursements. The cooperation of these officials of the municipality will greatly assist the Treasurer in making the system work.

Daily Cash Management Report

Having now instituted a cash receipts and disbursements system that will produce accurate and up-to-date data the Treasurer can receive information daily that will allow him to be aware of and make decisions affecting the cash position of his municipality. The information a Treasurer needs should come to him in what is commonly known as a daily cash management report.

This report will not only keep the Treasurer aware of the cash position of his municipality, but will also afford an excellent information base for the preparation of the cash budget. Exhibit I is an illustration of this type of report.

In addition to the internal cash management report, many banking institutions will, upon request, prepare reports concerning the municipality's cash position at the end of each day. Treasurers can use these to confirm the accuracy of their own internal reporting system.

Cash Budget

Cash budgeting involves the projection at least on a monthly basis, of receipts and disbursements to determine the cash requirements of the municipality.

Most municipalities prepare a cash budget that coincides with the municipal fiscal year, usually on a monthly basis although a number of municipalities prepare them on

a weekly or even daily basis.

The cash budget is prepared based on historical experience and an awareness of future events. To be effective, the cash budget should be updated on a regular basis throughout the year.

In addition to providing the Treasurer with the information necessary to establish prudent borrowing and investment practices the cash budget reveals the peaks and valleys of the municipality's cash flow and as a result can lead to improvements in the timing of this cash flow. Changes to the due dates of tax notices and scheduling of certain capital expenditures are two instances where the Treasurer can affect the cash position of his municipality.

ESTABLISHING AN EFFECTIVE CASH FLOW SYSTEM

The following steps for implementing a cash flow budget program are suggested:

1) Determine the basic seasonal fluctuations of cash inflows and outflows by reference to monthly bank statements for prior years. The time span should be sufficient to eliminate abnormal peaks and low points in balances.

2) Analyze receipts and disbursements into their component parts. Receipts should be distinguished by major source groups and disbursements by major object classes such as payroll, debt charges, school board and regional or county and other requisitions, and capital outlays. Major revenue categories would include property taxes, Provincial and Federal grants, charges for services, debenture

proceeds and miscellaneous revenues. Temporary investment and borrowing transactions can be excluded from this analysis.

3) Revise prior year data to reflect realistic changes in revenue and expenditure patterns during the time periods covered by the historical data. This compilation should permit the development of the basic receipts and disbursements assumptions to apply in the current year's projection.

4) Utilize prior years' experiences and current year capital and current budgeting worksheets, prepare projections of monthly receipts, disbursements and estimated net cash position balances for the revenue and capital funds. Departments making large payments for goods and services should provide individual forecasts of cash needs so that the Treasurer can predict with accuracy both the timing and magnitude of anticipated disbursements.

5) Consolidate capital and revenue fund monthly projections of receipts and disbursements.

6) Establish a routine to review the daily cash position and compare actual monthly results to the monthly projection.

7) Revise future monthly projections in light of actual results. Construction schedules, weather, emergencies or changes in operations can effectively disrupt anticipated flows. Continual review with all departments is essential in keeping future projections realistic.

8) Computation of the minimum cash balance that must be maintained in the bank represents the last step in ascertaining the periodic amounts required to be borrowed or available for investment. The minimum bank balance maintained by a municipality is normally determined with reference to two elements. These are:

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(i) the minimum average daily balance stipulated by the bank to compensate for services provided, and

(ii) a self-imposed amount to cover special circumstances and errors in the forecast.

The minimum bank balance a municipality adopts should be the aggregate of these two amounts.

DESIGN OF A CASH BUDGET

The design of a cash budget will be influenced by the range of information supplied by the municipality's accounting system and by the extent of municipal functions.

Exhibits 2 and 3 are illustrations of two types of cash budgets. Exhibit 2 is less detailed and is more suited to limited accounting systems. Exhibit 3 is designed for more detailed systems.

Both designs do, however, provide sufficient detail to allow the Treasurer to exercise control over the cash position of his municipality.

INVESTMENTS

Investment policy and practices is the last element in an effective cash management programme, and the one that enables the municipality to gain monetarily from all its previous efforts. Whether borrowing or investing, a Treasurer should encourage a degree of competition between the banks and investment houses on their interest rate bids. This is particularly important when investments or loans are renegotiated. Banks or investment houses should

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not, without consultation with the municipality, be permitted to reinvest since their interest rate on that particular day may not be the best rate attainable. The temporary investment of surplus funds with other municipalities and public bodies may often be mutually advantageous.

Section 312 of The Municipal Act sets out the types of security in which a municipality may invest monies not immediately required. Considering these legal limitations, the credit risk aspect of investing municipal funds is not usually a primary element of consideration, but some municipalities do set upper limits on the amount that can be invested in any one security. Even with restrictions on the amounts and types of authorized investments there does exist a diversity of short-term instruments.

If cash flows have been analyzed, cash control procedures implemented and a general understanding of the subtleties of the money market acquired, the Treasurer may not need to become personally expert in the intricacies of the money market, but could through his local banks and investment dealers make effective use of their expertise.

A publication concerning the types of investments that are available to Ontario municipalities is presently being prepared and will be available early in 1979; another on banking arrangements will be issued in that year.

EXHIBIT 1

Daily Cash Management Report

Date prepared July 24, 1978

	Current July 23 $	Year to Date $
General Account		
Opening balance	200,000	50,000
Deposits	150,000	3,500,000
Sub-total	350,000	3,550,000
Cheques issued	175,000	3,175,000
External Investments	-	200,000
Sub-total	175,000	3,375,000
Closing balance	175,000	175,000
Reserve Fund Account		
Opening balance	100,000	150,000
Deposits	200,000	400,000
Sub-total	300,000	550,000
Cheques issued	-	100,000
External Investments	200,000	350,000
Sub-total	200,000	450,000
Closing balance	100,000	100,000
External Investments		
General account	-	200,000
Reserve fund account	200,000	350,000
Total investment	200,000	550,000

Bank Loans	Outstanding	Borrowed To Date
Revenue fund	-	300,000
Capital fund	50,000	200,000
	50,000	500,000

Significant expenditures - Next 30 days

Purpose	Amount	Expected due date
Payrolls	250,000	July 31 & August 15th
Debenture payment	300,000	August 10th.

Significant Revenues: Next 30 days

Source	Amount	Expected due date
2nd Tax Installment	450,000	August 10th
Unconditional Grant	100,000	August 15th.

Capital and Revenue Cash Flow Projection

For The Year Ending December 31, 197
($000)

		January	February	March	December
OPENING BALANCES					
Bank (loans) outstanding		-	(20)	-	-
Temporary investments		10	10	50	70
Cash balances		5	6	19	2
		15	(4)	69	72
EXPECTED CASH RECEIPTS					
Current taxes		5	40	60	20
Payments-in-lieu		2	-	10	6
Ontario grants		-	15	-	80
Other revenues		1	5	10	5
Proceeds from debenture sales		-	30	-	-
Other capital financing		-	-	-	-
Temporary loans		20	-	-	-
Sale of investments		-	-	40	-
Total receipts	(A)	28	90	120	111
EXPECTED CASH PAYMENTS					
Payroll and fringe benefits		10	12	13	12
School boards requisition		-	-	30	30
Region or county requisition		-	-	40	-
Transfers to local boards or enterprises		2	-	10	20
Debenture debt charges		13	-	-	7
Capital expenditures		-	-	30	15
Repayment of temporary loans		-	20	-	-
Purchase of investments		-	40	-	10
Other expenditures		2	5	7	10
Total payments	(B)	27	77	130	104
Increase or (decrease) in cash balance (A-B)					
Balance		1	13	(10)	7
CLOSING BALANCES					
Bank (loans) outstanding		(20)	-		-
Temporary investments		10	50	10	80
Cash balance		6	19	9	9
		(4)	69	19	89

Capital and Revenue Cash Flow Projection

For the Year Ending December 31, 197-
($000)

	January	February	(000) March	December	Total
OPENING BALANCES					
Reserve fund (loans)					
Bank (loans)					
Temporary investments	220	50	500	280	
Cash balances	70	73	84	78	
RECEIPTS					
Current taxes	-	528	293	25	2,176
Tax arrears	46	46	24	12	236
Unconditional per capita grants				-	138
Tax Stabilization grants				-	364
M.T.C.-maint. & Construction	-	74	-	-	263
M.T.C.-transit grants			2	3	36
Social & Family Services grants	20	19	19	20	210
Library, recreation and museum grants				-	31
Income from investments	4		1	9	36
Contributions from own funds				-	-
Debt charges recoverable	42			-	174
Other revenue fund receipts	14	14	14	14	187
Proceeds from debenture issues				-	137
Other capital financing				170	170
Temporary loan receipts					
Sale of investments	170		100	280	1,405
Total receipts	296	681	453	533	5,733
DISBURSEMENTS					
Payroll and fringe benefits	131	122	131	140	1,640
Cost of temporary loans				-	-
Debenture debt charges	61			-	256
Contributions to own funds	25			40	140
Transfers to bds. and enterprises	8	10	24	24	219
Region or County requirements		6	79	86	351
Education requirements		14	169	189	766
Other revenue fund disbursements	58	58	58	58	696
Capital expenditures	10	10	10	-	476
Repayment of temporary loans				-	-
Purchase of investments		450		-	1,185
Total Disbursements	293	670	471	537	5,729
CLOSING BALANCES					
Cash balances	73	84	66	74	
Reserve fund (loans)	-	-	-	(120)	
Bank (loans)	-	-	-	(50)	
Temporary investment:	50	500	400	-	
NET CASH (LOAN) POSITION	123	584	466	(96)	